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# Sensitive Sectors in Free Trade Agreements


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# Sensitive Sectors

- Defined here as those that retain positive tariffs within an FTA
  - These are more common than I once thought

# Sensitive Sectors

- GATT/WTO requires only that
  - tariffs be eliminated on "substantially all the trade between the constituent territories on products originating in such territories."
  - (Note "originating." This raises the issue of Rules of Origin, which I will not address here.)

# Sensitive Sectors

- Why they are a concern:
  - Most likely to be sectors most vulnerable to competition from imports
  - Thus sectors most likely for **trade creation**
  - Exclusion of sensitive sectors
    - Reduces trade creation, while
    - Retaining trade diversion

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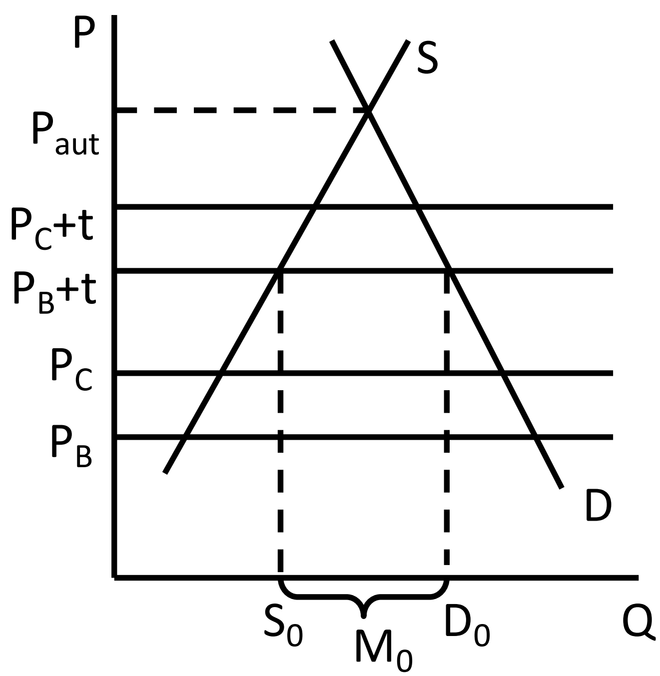
# Outline

- More on trade creation/diversion
- Data from TRAINS on FTA tariffs
  - Fractions of dutiable tariff lines
  - Rise in average maximum positive tariffs
- Characteristics of countries with most sensitive sectors

# Trade Creation and Diversion

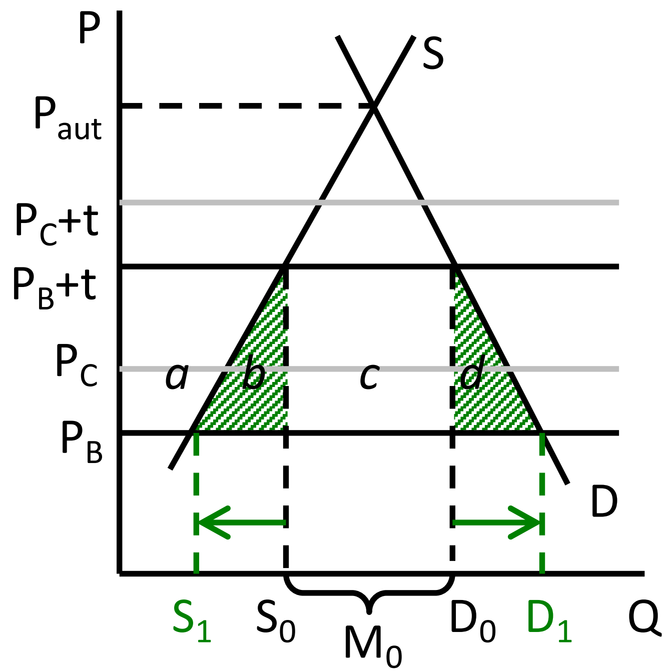
- Trade creation
  - Displaces domestic production with imports from low-cost partner
- Trade diversion
  - Replaces imports from low cost outsider with imports from high-cost partner
  - No (or minimal) dislocation

# No FTA, tariff t on both countries B and C




- Without FTA
  - Since $P_B$+t < $P_C$+t Home imports only from B

# FTA partner is low-cost country, B




**FTA with B**

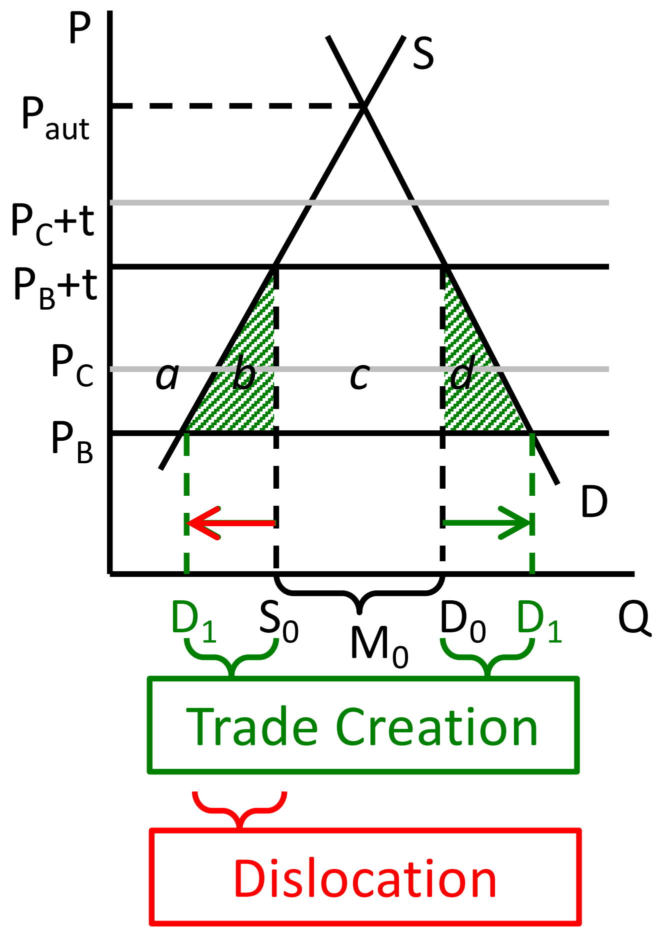
- Since $P_B < P_C$+t Home (A) still imports only from B
- Country C plays no role

**Welfare in Home Country A**

| | |
|---|---|
| Suppliers lose | –a |
| Demanders gain | +(a+b+c+d) |
| Government loses | –c |
| Country gains | +(b+d) |

Same as Free Trade

# FTA partner is low-cost country, B



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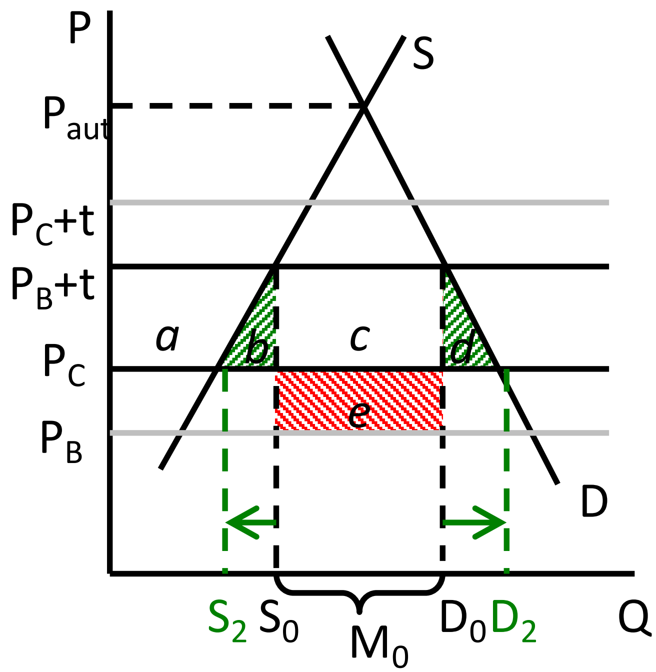
# FTA partner is high-cost country, C




FTA with C

- Since $P_C < P_B+t$ Home (A) now imports only from C

Welfare in Home Country A

Suppliers lose –a

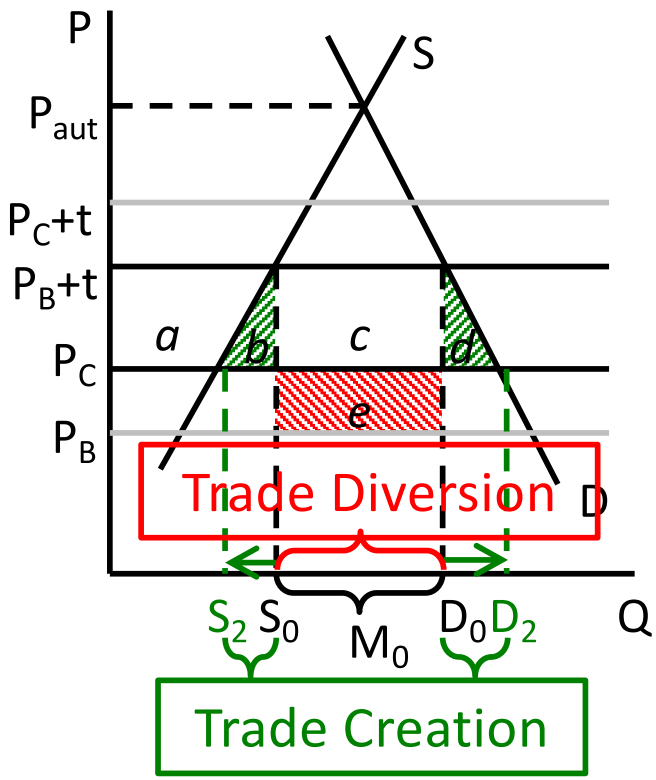
Demanders gain +(a+b+c+d)

Government loses –(c+e)

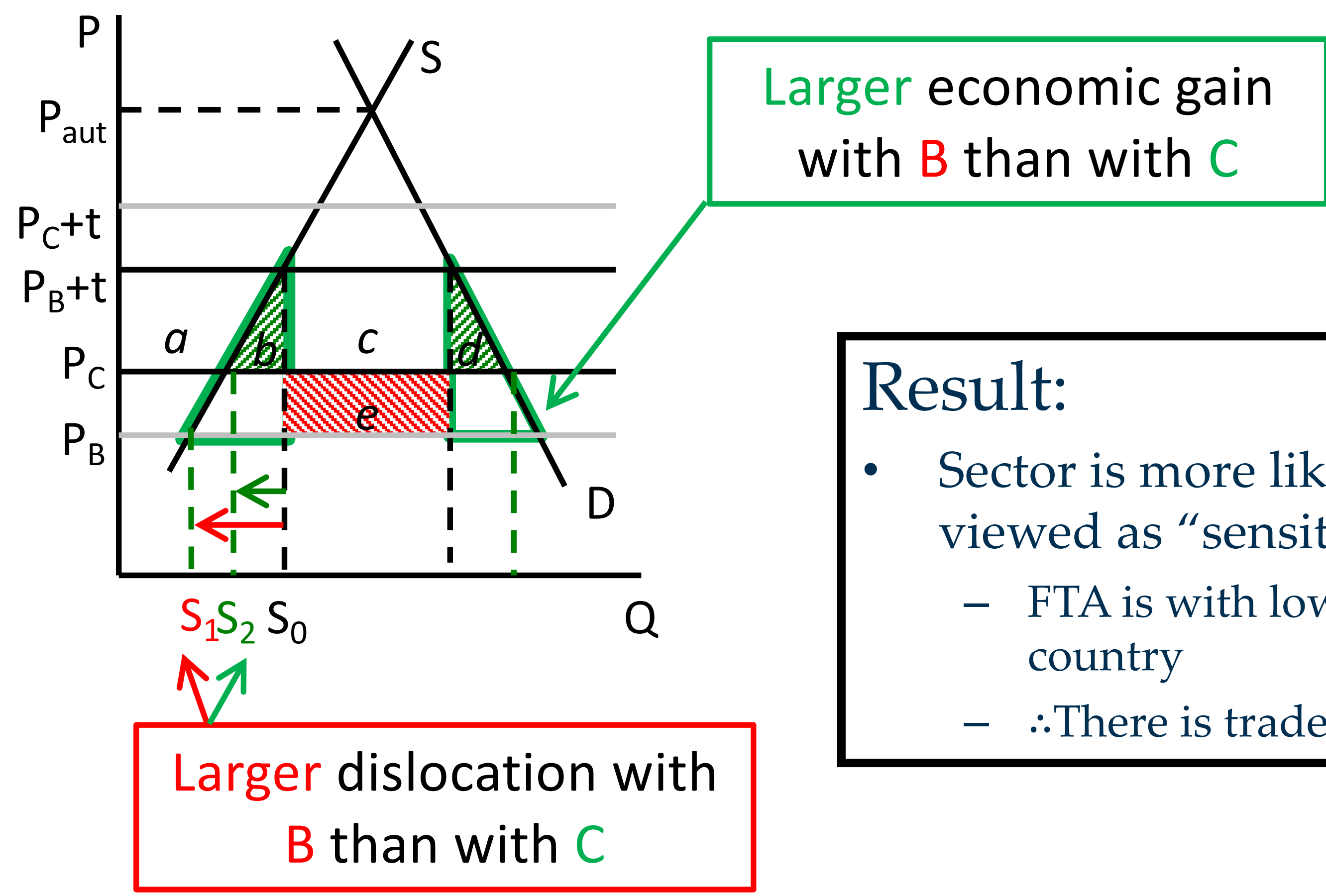
Country –e+(b+d)

[ loses if e>(b+d) ]

# FTA partner is high-cost country, C



# FTA partner is high-cost country, C




## Result:

- Sector is more likely to be viewed as "sensitive" if
  - FTA is with low-cost country
  - ∴There is trade creation

# Implication for a given FTA

- Sensitive sectors will be
  - Those for which the partner is the low-cost country
  - Those in which there will be trade creation
- Excluding tariff cuts in sensitive sectors will make (beneficial) trade creation less likely

# Data from TRAINS

- UNCTAD Trade Analysis Information System
  - Includes data from up to
    - 193 reporting countries
    - On imports from up to 272 exporters
  - 6-digit harmonized system
  - 1988-2014

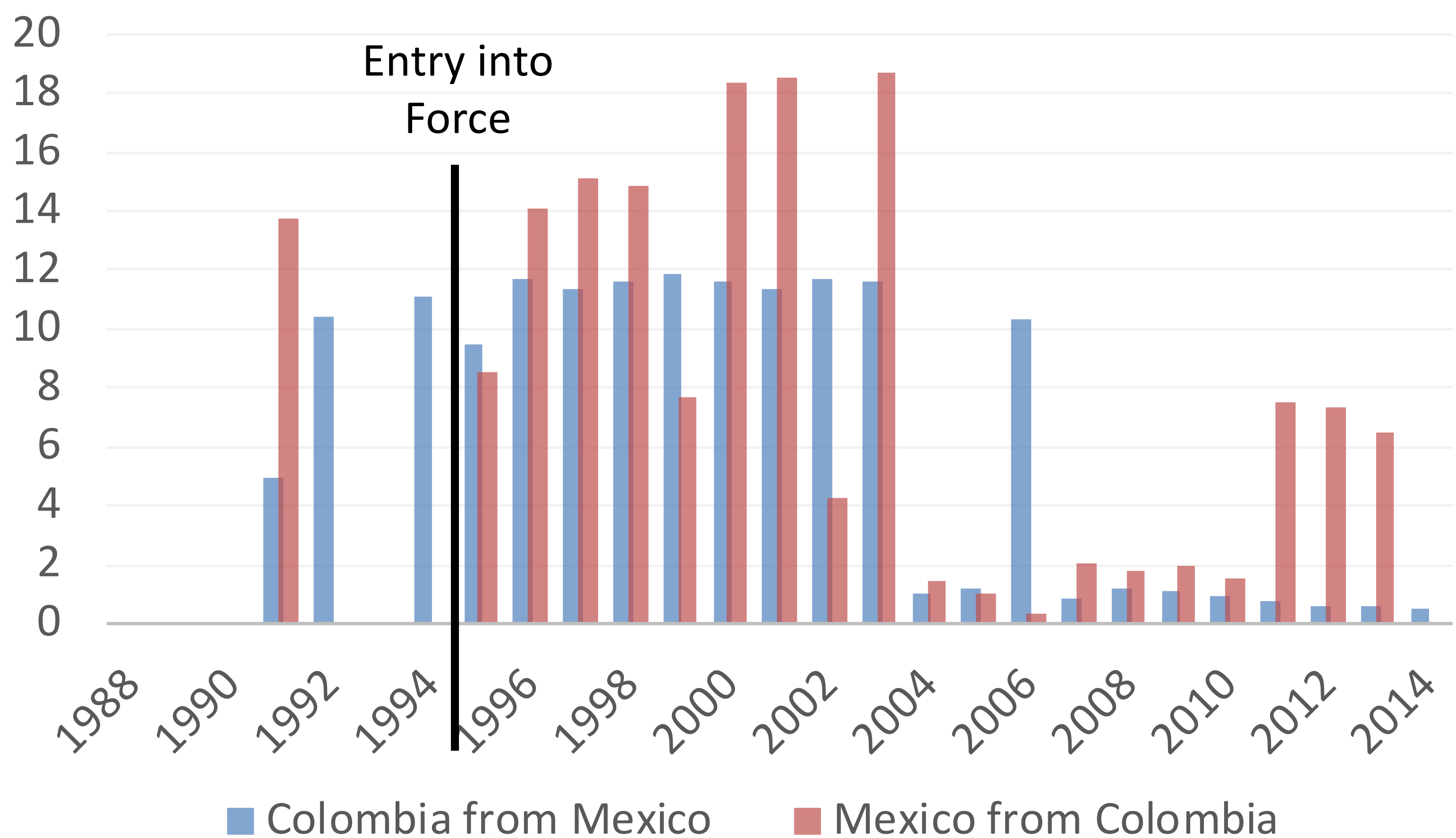
# Data from TRAINS

- Included:
  - Tariffs for 6-digit sectors
    - Simple average
    - Weighed average
    - Minimum and maximum rates
  - Number of tariff lines
    - Total
    - Dutiable
  - (Also includes data on value of imports, not used here.)

# Data from TRAINS

- Sample
  - The 1995 FTA between Colombia and Mexico
  - Shows several features of the data
    - Some useful
    - Some problematic

# Colombia-Mexico FTA Tariffs
## Simple average of simple average tariffs



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# Colombia-Mexico FTA Tariffs
## Dutiable percent of tariff lines

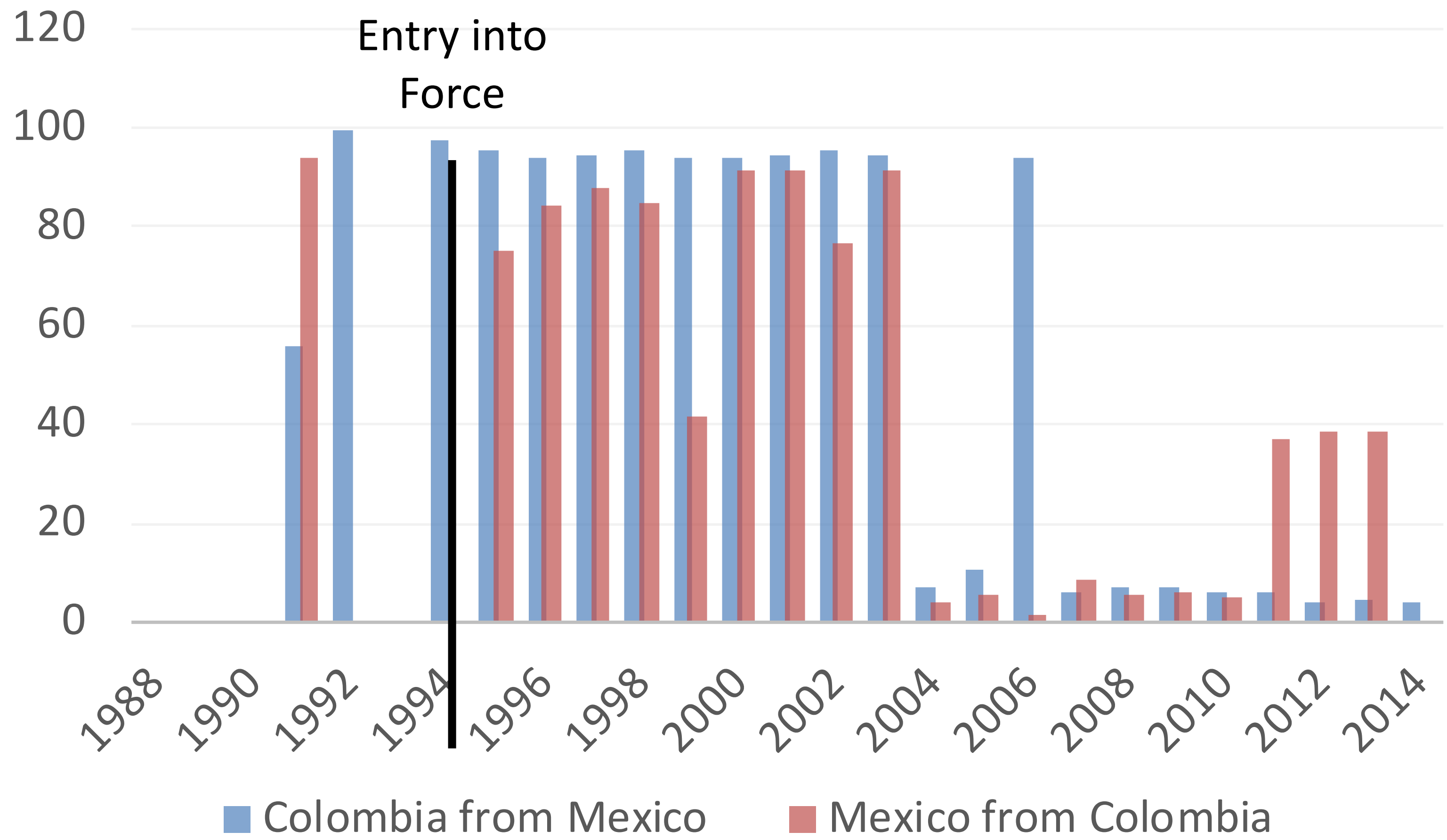

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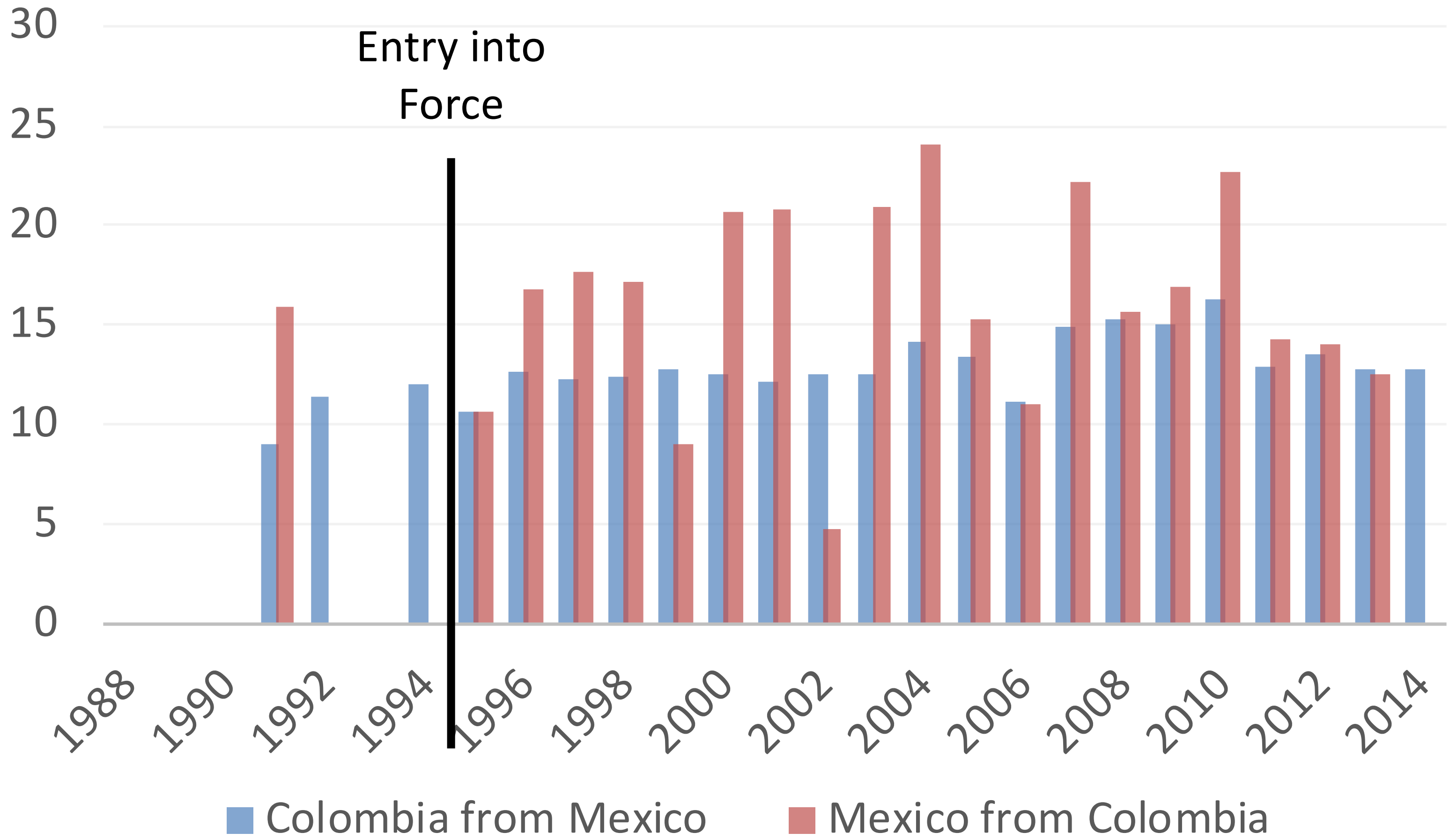
**Table 1**
**Percent Dutiable Tariff Lines in Colombia-Mexico FTA after They Dropped**

| Year | Colombia from Mexico | Mexico from Colombia |
| --- | --- | --- |
| 2004 | 7.1 | 3.8 |
| 2005 | 10.8 | 5.4 |
| 2006 | 93.9 | 1.6 |
| 2007 | 5.9 | 8.5 |
| 2008 | 7.2 | 5.3 |
| 2009 | 7.3 | 6.2 |
| 2010 | 6.1 | 4.9 |
| 2011 | 6.2 | 36.8 |
| 2012 | 4.2 | 38.4 |
| 2013 | 4.3 | 38.7 |
| 2014 | 3.8 | |

# Colombia-Mexico FTA Tariffs

## Simple average of maximum % positive tariffs within 6-digit codes



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## Table 2
## Minimum Percent Dutiable Tariff Lines (Min%Dut) and Change in Average Maximum Positive Tariffs (Pre-PostChg) for Available FTAs 1994-2003

| FTA | Year | Country | From | Min%Dut | Pre-PostChg |
|---|---|---|---|---|---|
| NAFTA | 1994 | Canada | Mexico | 0.6 | 122.4 |
| NAFTA | 1994 | Canada | US | 0 | 186 |
| NAFTA | 1994 | Mexico | Canada | 0.4 | 23.6 |
| NAFTA | 1994 | Mexico | US | 0 | 14.6 |
| NAFTA | 1994 | US | Canada | 0.1 | 40.8 |
| NAFTA | 1994 | US | Mexico | 0.5 | 17.5 |
| Columbia-Mexico | 1995 | Colombia | Mexico | 3.8 | 2.5 |
| Columbia-Mexico | 1995 | Mexico | Colombia | 1.6 | 0.6 |
| EU-Turkey | 1996 | EU | Turkey | 0.4 | 23 |
| EU-Turkey | 1996 | Turkey | Belgium | 7.6 | |
| EU-Turkey | 1996 | Turkey | France | 16.3 | 33.4 |
| EU-Turkey | 1996 | Turkey | Germany | 15.2 | 32.1 |
| EU-Turkey | 1996 | Turkey | Italy | 12.8 | 32.2 |
| EU-Turkey | 1996 | Turkey | Poland | 8.5 | 25.9 |

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## Table 2
## Minimum Percent Dutiable Tariff Lines (Min%Dut) and Change in Average Maximum Positive Tariffs (Pre-PostChg) for Available FTAs 1994-2003

| FTA | Year | Country | From | Min%Dut | Pre-PostChg |
|---|---|---|---|---|---|
| Canada-Israel | 1997 | Canada | Israel | 11.3 | 49.1 |
| Canada-Israel | 1997 | Israel | Canada | 3.9 | 6 |
| Israel-Turkey | 1997 | Israel | Turkey | 5.6 | 6 |
| Israel-Turkey | 1997 | Turkey | Israel | 10.9 | 20.8 |
| Canada-Chile | 1997 | Canada | Chile | 0 | 181.6 |
| Canada-Chile | 1997 | Chile | Canada | 79.1 | -4.5 |
| EU-Tunisia | 1998 | EU | Tunisia | 10.4 | 4 |
| EU-Tunisia | 1998 | Tunisia | Belgium | 23.3 | |
| EU-Tunisia | 1998 | Tunisia | France | 31.4 | -9.6 |
| EU-Tunisia | 1998 | Tunisia | Germany | 25.6 | -4.1 |
| EU-Tunisia | 1998 | Tunisia | Italy | 28.6 | -2 |
| EU-Tunisia | 1998 | Tunisia | Poland | 18.2 | 4.1 |
| Chile-Mexico | 1999 | Chile | Mexico | 1.2 | -4 |
| Chile-Mexico | 1999 | Mexico | Chile | 0.2 | 17.5 |

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# Table 2
## Minimum Percent Dutiable Tariff Lines (Min%Dut) and Change in Average Maximum Positive Tariffs (Pre-PostChg) for Available FTAs 1994-2003

| FTA | Year | Country | From | Min%Dut | Pre-PostChg |
|---|---|---|---|---|---|
| EU-South Africa | 2000 | EU | South Africa | 9.3 | 7 |
| EU-South Africa | 2000 | South Africa | Belgium | 3.1 | -5.3 |
| EU-South Africa | 2000 | South Africa | France | 4.6 | -6.1 |
| EU-South Africa | 2000 | South Africa | Germany | 3.8 | -7.5 |
| EU-South Africa | 2000 | South Africa | Italy | 5.6 | -7.6 |
| EU-South Africa | 2000 | South Africa | Poland | 4.5 | -5.5 |
| EU-Morocco | 2000 | EU | Morocco | 0.4 | 3.8 |
| EU-Morocco | 2000 | Morocco | Belgium | 12.6 | 1.8 |
| EU-Morocco | 2000 | Morocco | France | 15.9 | -15 |
| EU-Morocco | 2000 | Morocco | Germany | 8.9 | -17.5 |
| EU-Morocco | 2000 | Morocco | Italy | 12.1 | -20 |
| EU-Morocco | 2000 | Morocco | Poland | 11.5 | -14.8 |

**Table 2**
**Minimum Percent Dutiable Tariff Lines (Min%Dut) and Change in Average Maximum Positive Tariffs (Pre-PostChg) for Available FTAs 1994-2003**

| FTA | Year | Country | From | Min%Dut | Pre-PostChg |
|---|---|---|---|---|---|
| EU-Israel | 2000 | EU | Israel | 2.7 | 8 |
| EU-Israel | 2000 | Israel | Belgium | 3.8 | 8.5 |
| EU-Israel | 2000 | Israel | France | 3.6 | 9 |
| EU-Israel | 2000 | Israel | Germany | 3 | 8 |
| EU-Israel | 2000 | Israel | Italy | 3 | 7.4 |
| EU-Israel | 2000 | Israel | Poland | 4.3 | 9.4 |
| EU-Mexico | 2000 | EU | Mexico | 2.7 | 8 |
| EU-Mexico | 2000 | Mexico | Belgium | 3.8 | 8.5 |
| EU-Mexico | 2000 | Mexico | France | 3.6 | 9 |
| EU-Mexico | 2000 | Mexico | Germany | 3 | 8 |
| EU-Mexico | 2000 | Mexico | Italy | 3 | 7.4 |
| EU-Mexico | 2000 | Mexico | Poland | 4.3 | 9.4 |
| Israel-Mexico | 2000 | Israel | Mexico | 5.1 | 5.4 |
| Israel-Mexico | 2000 | Mexico | Israel | 2.2 | -0.1 |
| Macedonia-Turkey | 2000 | Macedonia | Turkey | 21.1 | |
| Macedonia-Turkey | 2000 | Turkey | Macedonia | 5 | 30.9 |

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# Table 2
## Minimum Percent Dutiable Tariff Lines (Min%Dut) and Change in Average Maximum Positive Tariffs (Pre-PostChg) for Available FTAs 1994-2003

| FTA | Year | Country | From | Min%Dut | Pre-PostChg |
|---|---|---|---|---|---|
| New Zealand-Singapore | 2001 | New Zealand | Singapore | 0 | 290.6 |
| New Zealand-Singapore | 2001 | Singapore | New Zealand | 0 | -332.8 |
| India-Sri Lanka | 2001 | India | Sri Lanka | 20.7 | -23.3 |
| India-Sri Lanka | 2001 | Sri Lanka | India | 28 | -2.8 |
| Jordan-US | 2001 | Jordan | US | 2 | -2.4 |
| Jordan-US | 2001 | US | Jordan | 0.9 | 71.1 |
| Chile-Costa Rica | 2002 | Chile | Costa Rica | 41.5 | -4.6 |
| Chile-Costa Rica | 2002 | Costa Rica | Chile | 6.8 | -2.4 |
| Chile-El Salvador | 2002 | Chile | El Salvador | 69.6 | -4.5 |
| Chile-El Salvador | 2002 | El Salvador | Chile | 2.5 | -3.9 |
| Canada-Costa Rica | 2002 | Canada | Costa Rica | 3.3 | -1.7 |
| Canada-Costa Rica | 2002 | Costa Rica | Canada | 27.7 | -2.5 |
| Japan-Singapore | 2002 | Japan | Singapore | 25.5 | 27.9 |
| Japan-Singapore | 2002 | Singapore | Japan | 0 | -220.2 |

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# Table 2
## Minimum Percent Dutiable Tariff Lines (Min%Dut) and Change in Average Maximum Positive Tariffs (Pre-PostChg) for Available FTAs 1994-2003

| FTA | Year | Country | From | Min%Dut | Pre-PostChg |
|---|---|---|---|---|---|
| El Salvador-Panama | 2003 | El Salvador | Panama | 3.8 | 2 |
| El Salvador-Panama | 2003 | Panama | El Salvador | 5.7 | -2 |
| China-Hong Kong | 2003 | China | Hong Kong | 56.3 | -13.9 |
| China-Hong Kong | 2003 | Hong Kong | China | 0 | |
| Bosnia-Herzegovina-Turkey | 2003 | Bosnia-Herzegovina | Turkey | 68 | 2.8 |
| Bosnia-Herzegovina-Turkey | 2003 | Turkey | Bosnia-Herzegovina | 0.6 | 25.1 |
| Australia-Singapore | 2003 | Australia | Singapore | 0.1 | -6.1 |
| Australia-Singapore | 2003 | Singapore | Australia | 0 | -158.7 |
| China-Macao | 2003 | China | Macao | 47.3 | -15.6 |
| China-Macao | 2003 | Macao | China | 0 | |

# Conclusions from the Data

- First, only very rarely do members of an FTA eliminate all tariffs on trade with other members.
  - Most continue to levy positive tariffs on a small percentage of tariff lines (percentages in the single digits) and
  - a large minority keep positive tariffs on much larger fractions.

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# Conclusions from the Data

- Second, there is a common tendency for the average maximum positive tariff to rise after the FTA compared to what it was before.
  - There are certainly a fair number of negative numbers in the Pre-PostChg column of Table 2,
  - but the positives far outnumber the negatives.

# Conclusions from the Data

- Two countries that do <u>not</u> show sensitive sectors:
  - Singapore
  - Chile

# Conclusions from the Data

- Singapore
  - Stands out as a country that has not protected sensitive sectors.
  - But then Singapore tended to have zero tariffs even before entering into FTAs.

# Conclusions from the Data

- Chile
  - Has been an eager participant in FTAs,
  - but it has a history of levying moderate tariffs of the same size against most imports, even before entering into FTAs, and
  - it seems to have kept that practice within FTAs, lowering bilateral tariffs only part way to zero.

# Implication of Rise in Average Maximum Positive Tariff

- Countries tend to
  - Reduce their lowest tariffs to zero
  - Keep largest tariffs in place
- This raises the variance of tariffs
- From literature on Piecemeal Tariff Reform, this seems likely to be additionally harmful

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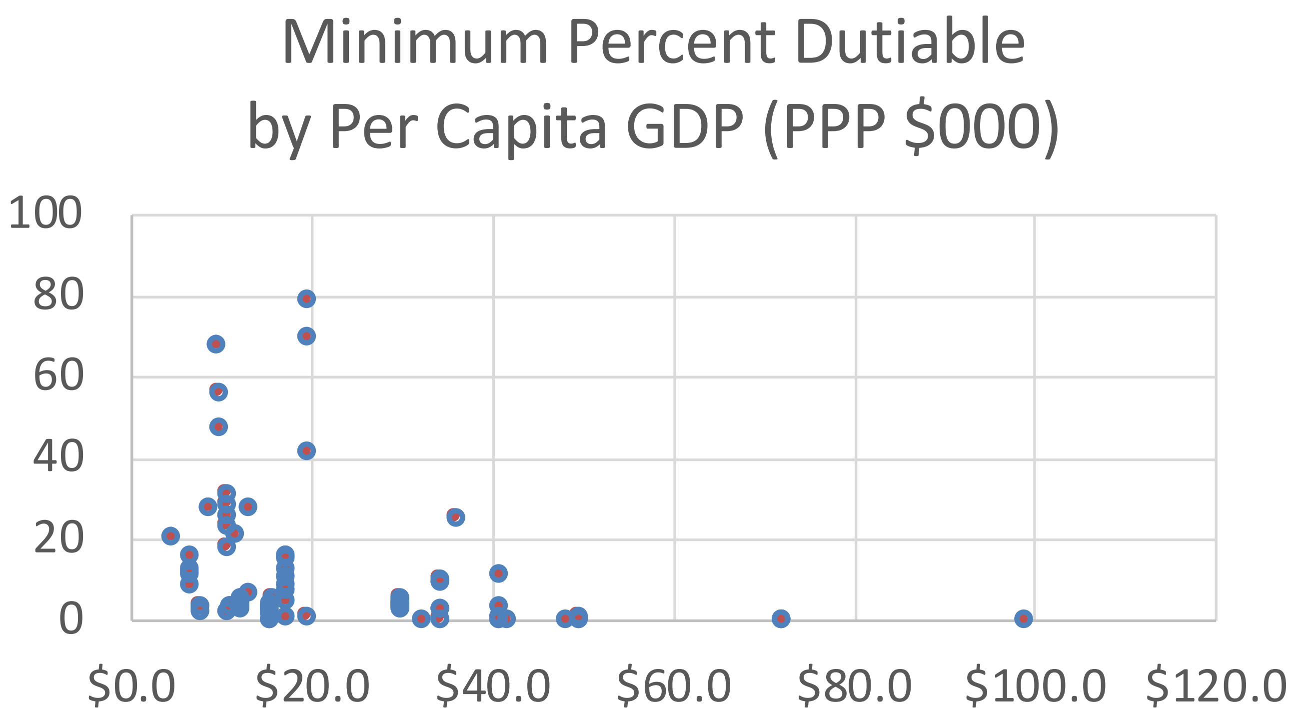
# Characteristics of Countries with Sensitive Sectors

- Graphs below relate % dutiable and change in max positive to
  - Per capita income
  - Population
  - Time
  - Social Policy

# Figure 7
# The Role of Per Capita Income



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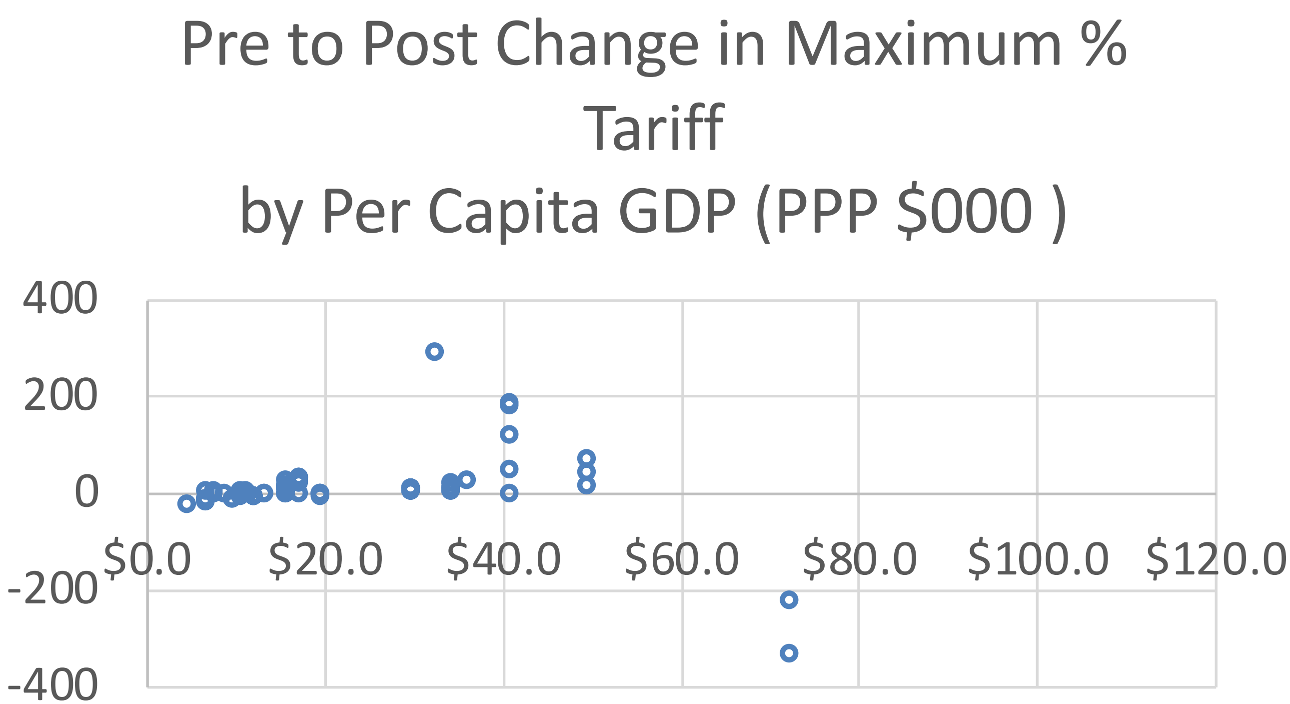
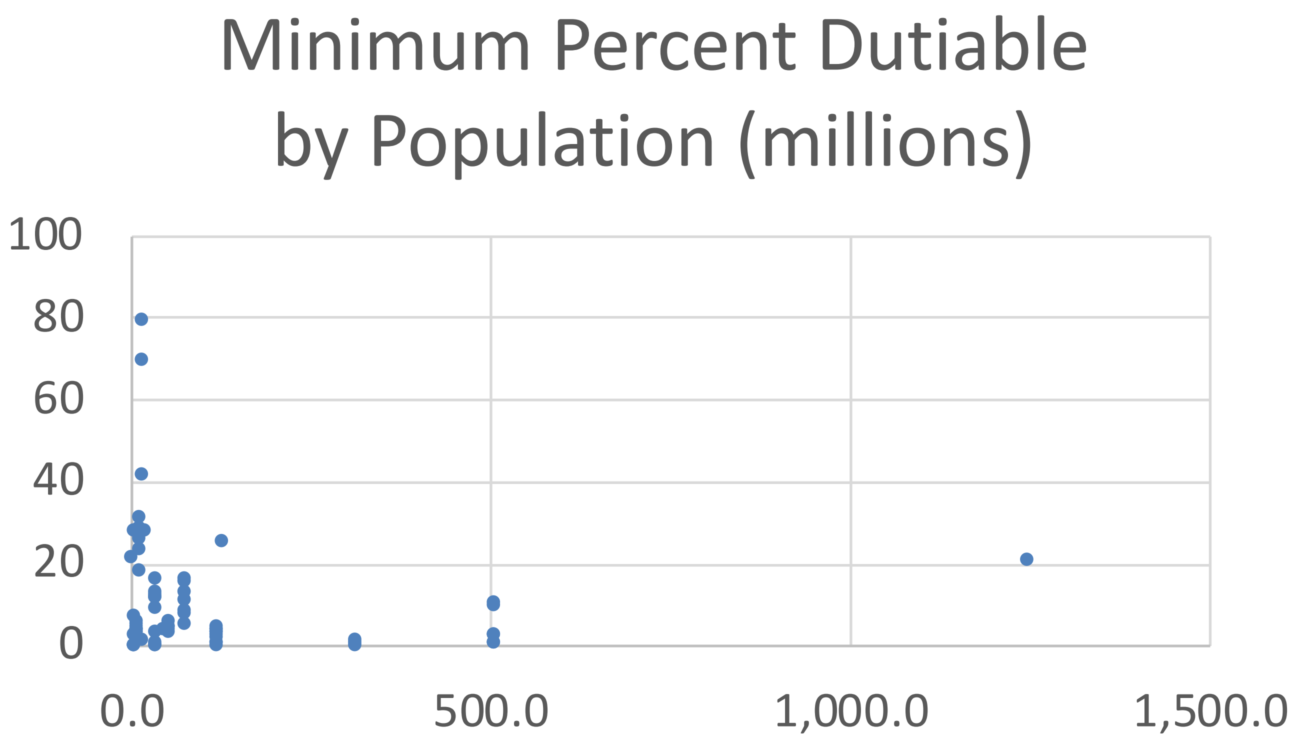
# Figure 7
# The Role of Per Capita Income



# Figure 8
# The Role of Population



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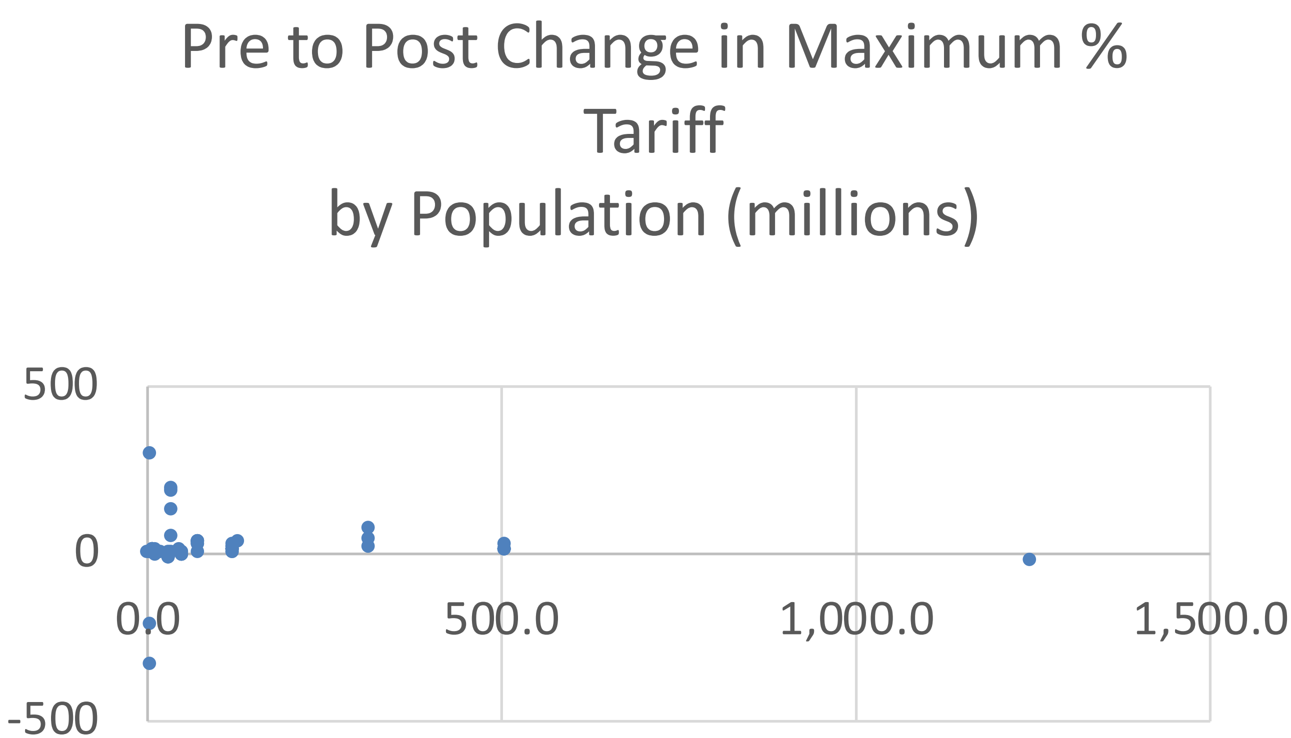
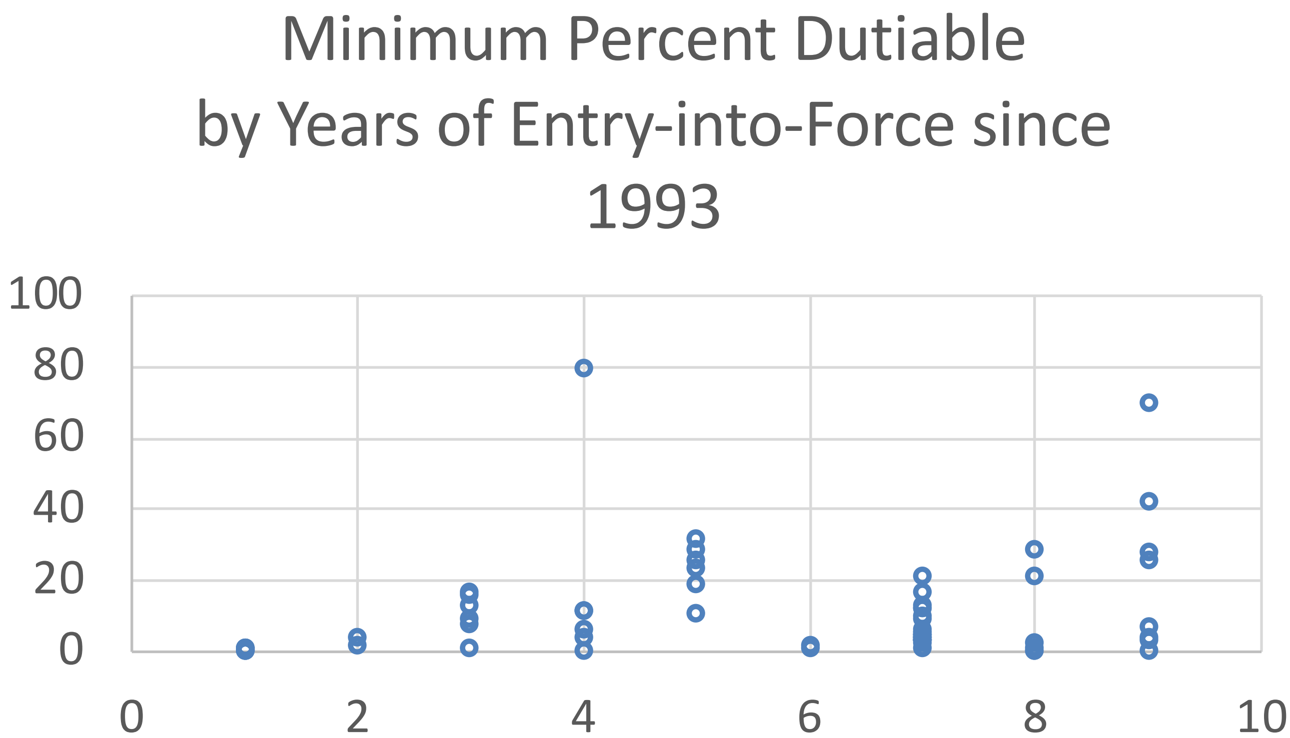
# The Role of Population



# Figure 9
# The Role of Time



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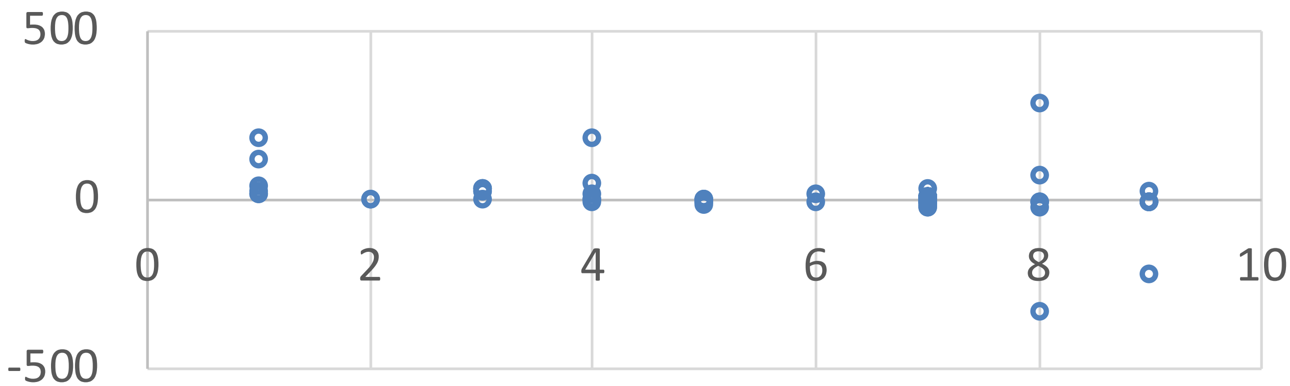
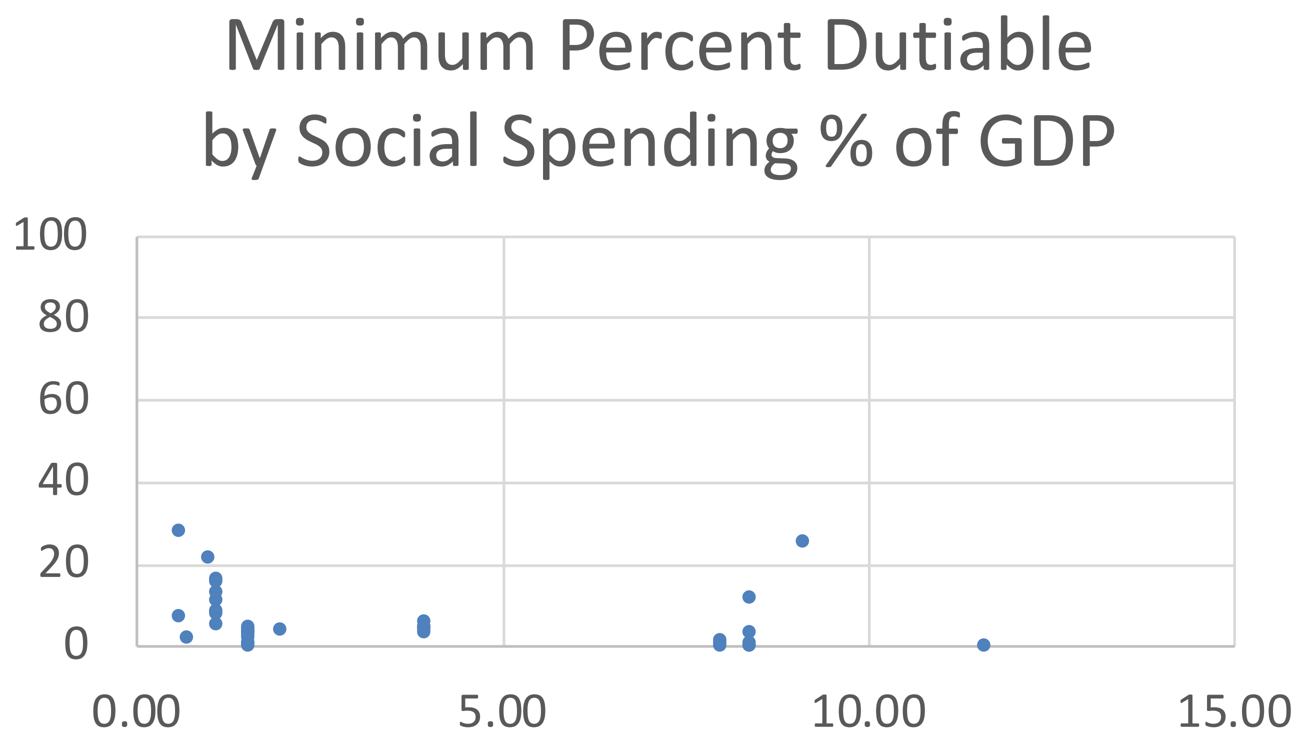
# Figure 9
# The Role of Time

Pre to Post Change in Maximum % Tariff
by Years of Entry-into-Force since 1993



# Figure 10
# The Role of Social Policy



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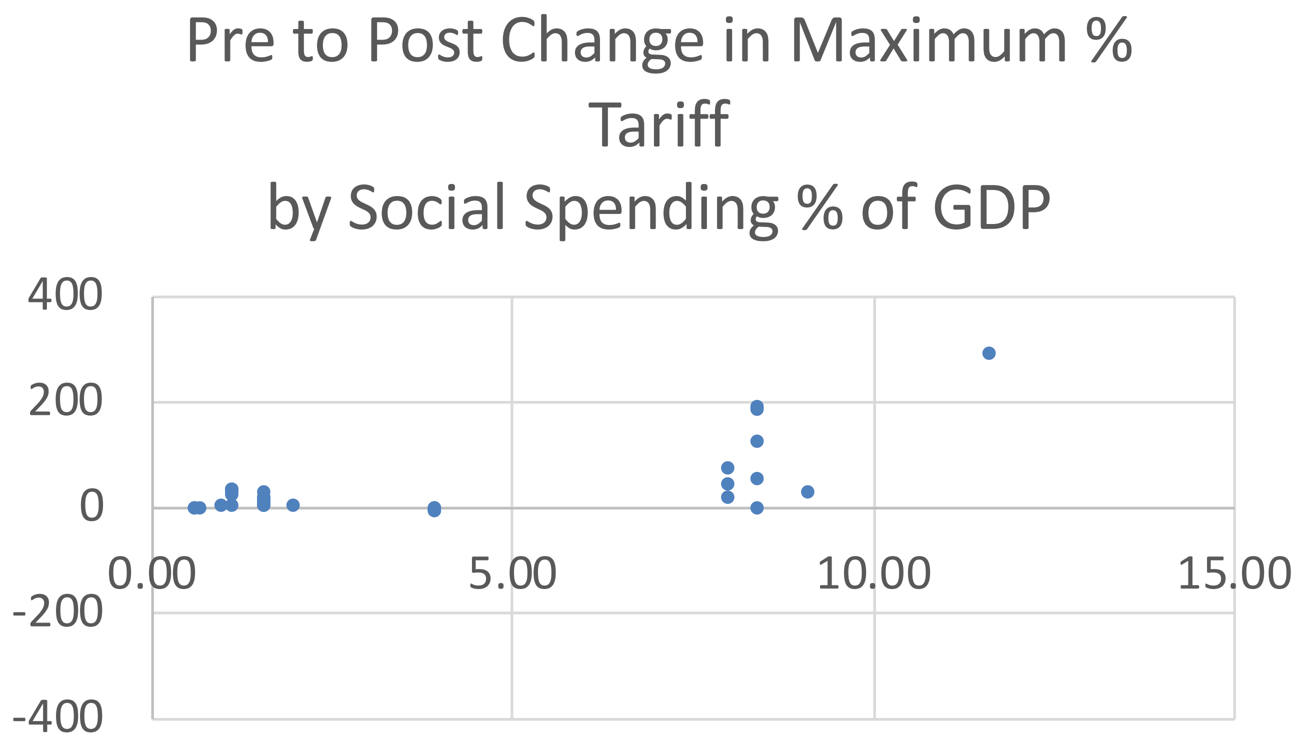
# The Role of Social Policy



# Conclusions

- Sensitive sectors are sufficiently common to be concerning
- Their presence
  - Reduces the benefits of FTAs
  - Makes it more likely that FTAs are harmful

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# Conclusions

- There is some tendency to
  - Increase the average maximum tariffs
- This increases the variance of tariffs, adding to the harm

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# Conclusions

- Policy recommendation?
  - Simply eliminate tariffs on all sectors?
  - Not that simple, as this ignores the reason for sensitive sectors
  - What is needed is better social policies to assist those in sensitive sectors adjust to import competition